No. 98-103

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

GHAITH R. PHARAON,

Petitioner,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

REPLY TO BRIEF IN OPPOSITION

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REPLY TO BRIEF IN OPPOSITION

1. The Government's Brief in Opposition does not dispute that the $37 million penalty levied upon petitioner Pharaon is grossly disproportional to any penalty ever levied upon a non-BCCI individual in a comparable case. It argues simply that "'no two cases are truly identical,'" Opp. Br. at 11 (quoting *TXO Production Corp. v. Alliance Resources Corp.*, 509 U.S. 443, 457 (1993) (plurality opinion)), and that the $37 million penalty "imposed on petitioner is not grossly disproportional in relation to *his* offense." Opp. Br. at 10 (emphasis added). The Government accordingly concludes that no review under the Excessive Fines or Due Process Clauses is warranted.

The Government, however, remains unable to identify the harm to which the $37 million penalty is supposedly proportional. In light of the court of appeals's order deleting from its opinion the sentence "Thirty-seven million dollars reflects the approximate amount the Board found BCCI invested in Independence, as well as approximating the gains sought and the potential harm posed by Pharaon's facilitation of BCCI's secret takeover of a bank worth several hundred million dollars," and the sentence "Indeed, BCCI's unrecoverable investment in the now-defunct Independence represents adequate 'financial loss or other damage' for purposes of the prohibition order," *see* Pet. App. 15, 17, 18-19, the Government cannot and does not argue that $37 million represents any actual harm to BCCI, nor does the Government deny that "BCCI eventually recovered its investment in Independence Bank," Opp. Br. at 9-10 n.2. Likewise, the Government does not argue that the $37 million represents any actual harm to BCCI's United States depositors, nor could it do so in light of the fact that all such depositors were fully paid in the course of BCCI settlement proceedings. *See, e.g., Hamid v. Price Waterhouse & Co.*,

No. CV 91-4483 CMB, 1992 WL 696398, at *1 (C.D. Cal. 1992) (noting that "no BCCI depositors who had money in United States offices on July 5, 1991 will lose their deposits"), *aff'd*, 51 F.3d 1411 (9th Cir. 1995), *cert. denied*, 516 U.S. 1047 (1996).

Instead, the Government now contends that the $37 million corresponds to the "*potential* losses" to which petitioner supposedly subjected BCCI, even if those potential losses were never realized. Opp. Br. at 9-10 n.2 (emphasis added); *see id.* at 9 ("BCCI's $40.5 million investment in Independence Bank became worthless when Independence Bank failed, subjecting BCCI and its world-wide depositors to a substantial *risk* of serious losses" (emphasis added)). The Government's "potential harm" theory should be rejected. To begin with, it is odd to hold Pharaon responsible for potential harm to BCCI -- itself the principal wrongdoer Pharaon allegedly aided and abetted. Moreover, as the Government omits to mention, the court of appeals deleted from its opinion the sole sentence containing any finding that petitioner had caused such "potential harm." Pet. App. 15 & 18.

Even putting these problems aside, the vague concept of "potential harm" has no bearing on the constitutionality of the penalty under the Excessive Fines Clause. In *United States v. Bajakajian*, 118 S. Ct. 2028 (1998), this Court interpreted that Clause to require that the amount of a penalty "bear some relationship to the gravity of the offense that it is designed to punish," *id.* at 2036, not some relationship to all the potential consequences of that offense. Justice Thomas's opinion for the Court in *Bajakajian* inquired solely into actual, not potential injury, concluding in that case that "[t]he harm that respondent *caused* was . . . minimal," *id.* at 2039 (emphasis added), and that the $357,144 forfeiture in

that case "bears no articulable correlation to any injury *suffered* by the Government." *Id.* (emphasis added).

Bajakajian cannot be distinguished from this case on the ground that the reporting requirements under the Bank Holding Company Act are prophylactic, or specifically directed at potential future harm, for the currency transaction reporting requirements at issue in *Bajakajian* are equally prophylactic, and yet this Court in that case declined to find potential harm relevant to a proportionality determination. To the contrary, the Court reasoned it was "impossible to conclude" that "the harm [Bajakajian] caused was "anywhere near 30 times greater than that caused by a hypothetical drug dealer who willfully fails to report taking $12,000 out of the country in order to purchase drugs," *id.* -- even though taking $375,144 out of the country obviously subjects the Government to a 30 times greater risk of *potential* loss than taking $12,000 out of the country in the event that any harm later materializes for which the Government seeks a fine or recoupment. The Court correctly ignored potential harm in *Bajakajian*, for consideration of such a factor would eviscerate any meaningful limit on the Government's discretion to set penalties arbitrary in amount.

Finally, the Government now advances for the first time the theory that the $37 million penalty somehow correlates to harm that petitioner supposedly caused to Independence Bank: "Had petitioner been truthful, the government would have learned of BCCI's illegal control of Independence Bank long before it did and could have acted to prevent its collapse. Pet. App. 132. Instead, Independence, a federally insured bank, became insolvent and was closed, requiring the government to repay investors and to seek recoupment from BCCI. *Id.* at 126." Opp. Br. at 9.

With respect, this assertion is wholly speculative and without foundation in the record. To begin with, the Government purposefully litigated this case on a theory of supposed harm to BCCI, which was regulated by the Federal Reserve, and not harm to Independence Bank, which was regulated by the State of California and the Federal Deposit Insurance Corporation, in order to justify the Board's jurisdiction. Even putting this problem aside, there is nothing in the record to suggest that Pharaon's participation in BCCI's reporting omissions -- as opposed to the collapse of the California real estate market or the Government's own seizure of Independence in connection with its proceedings against BCCI -- *caused* the "failure" of Independence Bank. The Government's citation to Pet. App. 126 is unavailing, for there the ALJ simply noted as a factual matter that "Independence Bank became insolvent and was closed by the California Banking Superintendent, and taken over by the Federal Deposit Insurance Corporation as receiver in January of 1992." Neither that nor any other finding below attributes the cause of the Independence Bank failure to the reporting omissions by Pharaon. Indeed, the cause of the Independence Bank failure (or seizure) simply was not an issue litigated or subjected to any fact-finding whatever in the proceedings below.

Even assuming that the Independence Bank closure could be attributed in part to petitioner, it is irrelevant because neither Independence, its depositors, nor the Government suffered any harm from that closure. As the Government concedes, "[a]s a result of a subsequent criminal forfeiture action against BCCI, the United States was able to recoup the cost of paying the insured depositors of Independence Bank." Opp. Br. at 9 n.1 (citing *United States v. BCCI Holdings (Luxembourg), S.A.*, 46 F.3d 1185, 1187 (D.C. Cir. 1995)). *See also* 1992 FDIC Ann. Rep. 33 (noting that all depositors of Independence, including those over the insurance limit,

were fully paid because the FDIC would be reimbursed from the BCCI fund). In other words, the $140 to $164 million cost to the Bank Insurance Fund in paying depositors was in fact borne by BCCI, not by the Fund. Thus, once again the Government is forced to rely on a theory of unrealized *potential* harm to Independence and the public fisc: "At the time of the Bank's closing, . . . there was no assurance that any of the FDIC's costs could be recovered." Opp. Br. at 9 n.1. This should be rejected for the same reasons given above for rejecting a theory of *potential* harm to BCCI.

The potential harm theory should also be rejected because, contrary to the Government's *ipse dixit*, there was not even any *potential* harm when Independence was closed. The Government is simply mistaken on this score and it thereby demonstrates the inappropriateness of referring to "facts" that are not part of the record and were never part of the proceedings below. Specifically, Independence Bank was closed on January 30, 1992, less than one week after BCCI's plea agreement was accepted by the Court in *United States v. BCCI Holdings (Luxembourg), S.A.*, No. CR 91-0655 (D.D.C.). BCCI's plea agreement specifically provided that the Bank Insurance Fund would be reimbursed from the approximately $552 million of BCCI assets in the United States. *United States v. BCCI Holdings (Luxembourg), S.A.*, 46 F.3d 1185, 1187-88 (D.C. Cir.), *cert. denied*, 515 U.S. 1160 (1995). The Government therefore had every assurance that the Bank Insurance Fund would be reimbursed when the Government closed Independence Bank six days after the plea was accepted. Indeed, it may be naturally inferred that it was upon that very assurance that the FDIC proceeded to close Independence Bank.

Left without any dollar amount of actual or even potential harm to which the $37 million penalty can plausibly be related, the Government suggests that petitioner's

supposed expectation of "substantial profits from his illegal activity," and his supposed "net worth of a 'half-a-billion dollars,'" are additional "circumstances" supporting a finding of proportionality in this case. Opp. Br. at 9-10. But both the ALJ and the Board expressly found that "Pharaon did not enjoy any material financial or other benefit" from his Independence transactions. Pet. App. 184; *see id.* at 35. And petitioner's wealth -- even assuming a then-decade-old declaration of net worth was probative of his wealth at the time the penalty was assessed -- cannot properly be a basis for an initial calculation of the appropriate penalty. The governing statute provides expressly that "the size of financial resources" of a defendant is relevant only as a *mitigating* factor to be applied after a presumptive penalty amount is already determined. 12 U.S.C. § 1818 (i)(2)(G).

In short, the Government has failed to demonstrate that the sum of $37 million is related, much less proportional, to any harm that petitioner's reporting omissions caused to BCCI, Independence, or the United States banking system, or to any other reasoned theory of retribution or deterrence. Accordingly, the question whether that penalty is grossly disproportional in violation of the Excessive Fines or Due Process Clauses warrants this Court's review.

2. The Government purports to distinguish the excessive fine invalidated in *Bajakajian* from the excessive fine in this case on the ground that Bajakajian was somehow less culpable than Pharaon. *See* Opp. Br. at 8 (suggesting that "Bajakajian was not a money launderer, drug trafficker, or tax evader," and that the impact on the United States of his failure to report was "'relatively minor'"). This distinction is unavailing. As Justice Kennedy noted in dissent in *Bajakajian*, Bajakajian was "far from an innocent victim": for example, "he was guilty of repeated lies to Government agents and suborning lies by others," and he "was unable to

give a single truthful explanation of the source" of the $375,144 in cash that he had concealed in his luggage. 118 S. Ct. at 2045 (Kennedy, J., dissenting). The majority did not dispute these facts but simply found them irrelevant to the question whether a forfeiture of $375,144 was sufficiently proportional to the offense of failing to report that sum to the Government.

Contrary to the Government's argument, petitioner's situation is in relevant respects just like Bajakajian's: he has been penalized solely for a failure to report, and the Government has not demonstrated that his failure to report caused the government or any other entity any material harm. A $37 million penalty that is without remote parallel in the Board's settled penalty practice outside the BCCI context is therefore just as unconstitutionally excessive in these circumstances as was a $357,144 forfeiture for a reporting violation that normally carried no more than a $5000 fine. See *Bajakajian*, 118 S. Ct. at 2039.

3. If there is any doubt that a $37 million penalty is grossly disproportional to the nonreporting offenses at issue here, this Court at a minimum should grant the petition, vacate the decision below, and remand to the court of appeals for reconsideration in light of *Bajakajian*. *Bajakajian* intervened after the decision of the court of appeals below, and petitioner's excessive fine claim has never been considered under the standard set forth in that decision.

The Government contends that the court of appeals decision in fact conformed anticipatorily with the Eighth Amendment requirements this Court later set forth in *Bajakajian*, *see* Opp. Br. at 7-8, but this effort to rewrite the decision below is unsuccessful. According to the Government, the court of appeals considered "'the value of the fine in relation to the offense' . . . de novo, and

concluded that the penalty imposed on petitioner was 'proportional to his violation.'" Opp. Br. at 7 (citing Pet. App. at 15, 16).

But the Government omits the factual predicate offered by the appeals court for its finding of proportionality: the relevant sentence in fact reads, "*As we have already indicated in rejecting Pharaon's APA challenge*, the penalty is proportional to his violation . . . ." Pet. App. 16 (emphasis added). The court's rejection of the APA challenge rested in turn principally on the sentence the court of appeals later deleted in its order of April 17, 1998: "Thirty-seven million dollars reflects the approximate amount the Board found BCCI invested in Independence, as well as approximating the gains sought and the potential harm posed by Pharaon's facilitation of BCCI's secret takeover of a bank worth several hundred million dollars." Pet. App. 15; *see id.* at 18. Stripped of that sentence, the court of appeals opinion contains no basis for finding the assessed penalty proportional to Pharaon's violation other than the fact that the penalty was within the statutory maximum. But *Bajakajian* expressly rejected the proposition that a penalty's conformity with a statute can settle the question of its proportionality under the Excessive Fines Clause. *See Bajakajian*, 118 S. Ct. at 2038 n.14.

Accordingly, the decision of the court of appeals, as amended to exclude any factual predicate for the proportionality of the $37 million penalty to the gravity of petitioner's offense, cannot be read to have anticipatorily applied the law set forth in *Bajakajian*. At a minimum, the court of appeals should be required to reconsider the record de novo on remand in light of this Court's decision in *Bajakajian*.

4. The Government argues that petitioner's challenge to his penalty under the Due Process Clause should be disregarded "[b]ecause the Excessive Fines Clause provides an explicit textual source of protection against excessive civil penalties". Opp. Br. at 10-11. Obviously, if petitioner's excessive fine claim is rejected, this argument fails and his due process claim must be considered in the alternative.

The Government's sole answer to petitioner's due process argument on the merits is that petitioner received "adequate notice" because his penalty fell within the statutory maximum. Opp. Br. at 11. This answer ignores the point that the Due Process Clause secures values ranging beyond fair warning to individuals. As Justice Breyer, joined by Justices O'Connor and Souter, wrote in concurrence in *BMW of North America v. Gore*, 517 U.S. 559, 587 (1996): "Requiring the application of law, rather than a decisionmaker's caprice, does more than simply provide citizens notice of what actions may subject them to punishment; it also helps to assure the uniform general treatment of similarly situated persons that is the essence of law itself." For that reason, it is also irrelevant whether decisions illustrating the gross disproportionality of the Board's treatment of Pharaon preceded or followed the assessment of the penalty against him. *See* Opp. Br. at 12 n.3. A $37 million penalty without remote parallel either before or after is the essence of a departure from the rule of law.

CONCLUSION

For these reasons and the reasons set forth in the Petition for a Writ of Certiorari, the petition should be granted, or, in the alternative, the petition granted and the decision below vacated and remanded to the court of appeals.

Dated: Stanford, California
September 24, 1998

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